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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 228

TENNESSEE GAS TRANSMISSION COMPANY,
Appellant,

v.

MISSISSIPPI STATE TAX COMMISSION,
Appellee.

Appeal from the Supreme Court of the State of Mississippi

JURISDICTIONAL STATEMENT

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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Appeal from the Supreme Court of the State of Mississippi

STATEMENT AS TO JURISDICTION

Appellant appeals from the judgment of the Supreme Court of the State of Mississippi entered on December 14, 1959, reversing a final decree of the Chancery Court of the First Judicial District of Hinds County, Mississippi, entered on January 27, 1959, and submits this statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that a substantial question is presented.

OPINION BELOW

The opinion of the Supreme Court of the State of Mississippi is reported in .... Miss. .... and 116 So. 2d 550. Opinions of the Chancery Court of Hinds County, Mississippi are not reported. A copy of the opinion of the Supreme Court of the State of Mississippi, together with the dissent thereto, is attached hereto as Appendix A and a copy of the opinion of the Chancery Court of Hinds County is attached hereto as Appendix B.

JURISDICTION

This proceeding was initiated by timely petitions of appellant to the Mississippi State Tax Commission under section 9328 of the Mississippi Code of 1942, Recompiled, as amended, 1956, for the correction of assessments of franchise tax for each of the franchise tax years 1956 and 1957, as imposed in accordance with the provisions of section 9319, Mississippi Code of 1942, Recompiled, as amended, 1956, and for a refund of any excess taxes paid. The Mississippi State Tax Commission, by order dated October 3, 1957, affirmed the assessments and rejected and overruled the petitions. The Chancery Court, First Judicial District, Hinds County, Mississippi, by final decree, dated January 27, 1959, reversed and set aside the Mississippi State Tax Commission's order and entered judgment for appellant. The Supreme Court of the State of Mississippi reversed the decree of the Chancery Court of Hinds County, Mississippi, and reinstated and affirmed the order of the Mississippi State Tax Commission of October 3, 1957, but modified that order so as to award appellant a refund of $710. Judgment was entered in the Supreme Court of the State of Mississippi on De-

cember 14, 1959 (R. 118). A copy of this judgment is attached hereto as Appendix C. On February 1, 1960, the Supreme Court of the State of Mississippi overruled a Suggestion of Error that had been timely filed by appellant in that court subsequent to its judgment (R. 119). A copy of this order is attached hereto as Appendix D. Notice of appeal to this Court was filed in the Supreme Court of the State of Mississippi by appellant on March 11, 1960 (R. 121). By order dated April 27, 1960, a Justice of the Supreme Court of the State of Mississippi enlarged the time for docketing the case in this Court to and including July 9, 1960. A certified copy of that order is submitted with and made a part of the record herein.

The Jurisdiction of the Supreme Court of the United States to review the decision in this case on appeal is conferred by Title 28, U.S. Code, Section 1257(2), as the decision was rendered by the highest court of the State of Mississippi and held that the Mississippi statute in question was not repugnant to the Constitution of the United States.

The following decisions sustain the jurisdiction of the Supreme Court to review by appeal the judgment in this case: *Railway Express Agency, Inc.* v. *Virginia*, 358 U.S. 434 (1959); *International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947); *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942); and *Hans Rees' Sons, Inc.* v. *North Carolina, ex rel. Maxwell*, 283 U.S. 123 (1931).

QUESTIONS PRESENTED

The Federal questions presented below and on this appeal are:

1. Whether the franchise tax imposed upon appellant by the State of Mississippi, as computed in ac-

cordance with the provisions of section 9319 of the Mississippi Code of 1942, Recompiled, as amended by Chapter 412, section 4, of the Laws of Mississippi of 1956, is invalid as being repugnant to the Commerce Clause, Article I, section 8, of the Constitution of the United States and also constituted a violation of appellant's rights under the Equal Protection and Due Process Clauses of the Fourteenth Amendment to the Constitution of the United States, in that appellant was required under said section to compute the value of capital employed in the State of Mississippi, which is the measure of the tax, under a formula which required the inclusion as a part of the amount of gross receipts from business carried on in Mississippi of amounts which were artificially computed and which constituted gross receipts from business done wholly outside the state, thus making extraterritorial commerce or interstate commerce a predominant factor in such computation and resulting in an allocation of such capital subject to the aforesaid franchise tax that was arbitrary, unreasonable and discriminatory.

2. Whether the Mississippi franchise tax imposed upon appellant as computed under section 9319 of the Mississippi Code of 1942, Recompiled, as amended by Chapter 412, section 4, of the Laws of Mississippi of 1956, is invalid and repugnant to the Commerce Clause, Article I, section 8, of the Constitution of the United States and to the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States in that said statute required extraterritorial capital to be subject to the Mississippi franchise tax and thereby placed an undue burden on the interstate commerce business of appellant and subjected appellant to the deprivation of property without due process of law.

STATUTE INVOLVED

The statute of the State of Mississippi, the validity of which is here brought into question, is section 9319, Title 37, Chapter 2, of the Mississippi Code of 1942, Recompiled, as amended by Chapter 412, section 4, of the Laws of Mississippi of 1956, which reads as follows:

"§ 9319. *Multistate corporations.*

"In the case of organizations doing business both within and without Mississippi, the value of the capital employed in this state shall be determined by first computing the ratio between (1) the real and tangible personal property owned or used in Mississippi and gross receipts from business carried on in Mississippi and (2) the total real and tangible peronal property and gross receipts wherever located and from wherever received. Said ratio then shall be applied to the total capital stock, surplus, undivided profit and true reserves and the result of that application shall be the capital employed in this state. Provided, however, that the amount of the determined capital in Mississippi shall in no case be less than the assessed value of the property of the organization for the year preceding the year in which the return is due.

"For the purpose of this section, an organization which uses a formula method of apportionment in making income tax returns to this state shall determine its gross receipts from business carried on in Mississippi by applying to total unitary receipts the ratio achieved, or which would be achieved, by such formula and adding to the result of such application any nonunitary Mississippi receipts."

The whole of Chapter 2, Title 37, Mississippi Code of 1942, Recompiled, as amended by the Laws of Mississippi of 1956, is printed as Appendix E hereto.

STATEMENT OF THE CASE

The material facts in this case appear in the stipulation of the parties and the exhibits attached thereto (R. 41-48). Appellant is a Delaware corporation with its principal offices in Houston, Texas. It is, and during the franchise tax years 1956 and 1957 was, qualified to do business in the State of Mississippi. Appellant owns and operates approximately 925 miles of natural gas transmission pipelines in Mississippi through which it transmits natural gas gathered in the states of Texas and Louisiana to areas in northern states. In connection with its pipeline, appellant maintains in Mississippi four compressor stations, eighteen meter stations, and has there a number of operating and maintenance employees. Appellant, for the franchise tax years 1956 and 1957, also owned and operated approximately forty-five automobiles, trucks and trailers, and owned dwelling houses on its compressor station properties used by its operating and maintenance employees.

During the franchise tax years 1956 and 1957, appellant made no direct sales or deliveries of gas in the State of Mississippi but, during said years, did deliver some wholesale quantities of gas therein. Appellant had a partial interest in thirteen oil wells in Mississippi, none of which it operated. The oil holdings of appellant within the State of Mississippi are, and were during these years, such that they can be clearly shown to be distinct and separable from the operation of its natural gas pipeline transmission system and could be discontinued entirely without causing a withdrawal from its interstate gas transmission business. The ex-

tremely small amount of business carried on in Mississippi by appellant is shown by a comparison of receipts from its various activities in or related to Mississippi with those from its over-all pipeline operations. The gross revenue from appellant's oil holdings in Mississippi for the period effective for the franchise tax year 1956 was $66,253 and revenue from its dwelling houses on compressor station properties was $6,136. For this same period receipts from interstate wholesale gas deliveries in Mississippi amounted to $1,324,944. Contrasted with this, total receipts on wholesale gas deliveries in interstate commerce for the period amounted to $160,565,026.

Title 37, Chapter 2, Mississippi Code of 1942, Recompiled, as amended, imposes a franchise tax on both foreign and domestic corporations doing business within the State of Mississippi (Appendix E, *infra*). Section 9314 imposes a tax on foreign corporations equal to $2 of each $1,000, or fraction thereof, of the value of capital used, invested or employed within the state. Section 9319 of the Code, *supra*, as amended in 1956, prescribes a formula to be used in determining the amount of capital employed in the state in the case of organizations doing business both within and without Mississippi. It provides that the total capital stock, surplus, undivided profits and true reserves of the taxpayer are to be multiplied by a percentage ratio or fraction. The numerator of this ratio is the real and tangible personal property owned or used in Mississippi, plus the gross receipts from business carried on in Mississippi. The denominator is the total real and tangible personal property wherever located, plus the gross receipts wherever located and from wherever received. The result of the application of the ratio or

fraction thus obtained is the capital employed in the state, or the base upon which the franchise tax is levied, as indicated above.

Prior to the enactment of Chapter 412, section 4, of the Laws of Mississippi of 1956, the apportionment formula for determination of capital employed in the state was in substance that set forth above. However, the statute as it then existed did not direct the method of determining gross receipts from business carried on in Mississippi, and appellant computed that figure as required by the State Tax Commission by adding: (a) its receipts from wholesale gas deliveries in the state, (b) receipts from all oil properties in the state, and (c) rentals from houses on its compressor station properties in the state (R. 96).

Section 9319, as amended in 1956, *supra*, now requires an organization which uses a formula method of apportionment for income tax purposes to determine its gross receipts from business carried on in Mississippi by applying to total unitary receipts the ratio achieved by such income tax formula and adding to the result of such application any non-unitary Mississippi receipts.

Appellant uses a formula method of apportionment in making its income tax returns to the State of Mississippi (R. 50). Being a foreign corporation and a pipeline (other than a carrier), appellant was required for the years under consideration to make income tax returns under the apportionment formula provided by Mississippi State Tax Commission Regulations No. 10, Article 250, and No. 11, Article 247. Article 250 of Regulations No. 10 requires the use of a ratio which consists of the average of the sum of the ratios of the following factors: (1) the ratio of gross revenues aris-

ing within the state from unitary operations as related to the total corresponding gross revenues of the system; (2) the ratio of the average accumulated investment in real and tangible personal property used or employed in connection with the unitary operations within Mississippi as related to the total for the system; and (3) the ratio of salaries and wages paid or incurred in the unitary operations within Mississippi as related to the corresponding total for the system. The ratio required by Article 247 of Regulations No. 11 is that obtained by taking the arithmetical average of the following three ratios: (1) pipeline property owned or used in Mississippi to total pipeline property; (2) Mississippi operating labor to total operating labor; and (3) deliveries in Mississippi to total deliveries. The regulations also provide the types of property and adjustments which are to be taken into consideration in arriving at property values, specify the wages and other compensation that are to be taken into consideration and those which are to be excluded in arriving at the labor factor, and also provide that the ratio with respect to deliveries shall be determined by dividing revenue derived from deliveries in Mississippi by revenue derived from total deliveries. A copy of each of the Mississippi State Tax Commission Regulations No. 10, Article 250, and No. 11, Article 247, is attached hereto as Appendix F.

Appellant brought this action by petition and appeal in the Chancery Court of the First Judicial Circuit of Hinds County, Mississippi, against the Mississippi State Tax Commission seeking reversal of an order of that Commission dated October 3, 1957 (R. 26-27), denying appellant's request for a redetermination of liability and refunds of overpayments of franchise tax

in the amounts of $5,412 and $7,143 for the franchise tax years 1956 and 1957, respectively. In its First Amended Original Petition, dated May 16, 1957, to the Commission, appellant contended that the final paragraph of section 9319, Mississippi Code of 1942, Recompiled, as amended in 1956, *supra*, was invalid, as being repugnant to the Constitution of the United States, and thus gave rise to an overassessment of tax by that body (R. 12-17).

In its petition in the Chancery Court, appellant urged upon that court the invalidity of the statute in question because of its violation of the Commerce Clause of the Constitution of the United States and of the Equal Protection and Due Process Clauses of the Fourteenth Amendment to the Constitution of the United States. It also incorporated in that petition its previous petitions to the Mississippi State Tax Commission for each of the franchise tax years 1956 and 1957 (R. 3, 4, 8).

The Chancery Court sustained appellant's contentions and overruled the Mississippi State Tax Commission's order, concluding that (R. 75-76):

> "For the reasons herein enumerated, the mandatory requirement, contained in Section 4, Chapter 412, Laws of the State of Mississippi enacted in 1956, that 'For the purpose of this section, an organization which uses a formula method of apportionment in making income tax returns to this state shall determine its gross receipts from business carried on in Mississippi by applying to total unitary receipts the ratio achieved, or which would be achieved, by such formula and adding to the result of such application any nonunitary Mississippi receipts' is unconstitutional because it violates the Commerce Clause (Article I, Section VIII) of the Constitution of the United States."

On January 27, 1959, the Mississippi State Tax Commission filed a notice of appeal in the Chancery Court (R. 79) and, subsequently, submitted an assignment of errors to the Supreme Court of Mississippi (R. 83), alleging that the final decree in the lower court was contrary to law and contending in paragraphs 3 and 4 that:

> "3. The lower court erred in holding that the franchise tax formula, as provided for by section 9319, *Mississippi Code of 1942*, as amended by the Mississippi Legislature in 1956, places an undue burden on interstate commerce and caused a duplication of taxes on the same gross receipts from interstate (*sic*) in other states through which appellee's interstate gas transmission lines run.
>
> "4. The lower court erred in holding it mandatory that the requirement contained in section 4, Chapter 412, *Laws of the State of Mississippi enacted in 1956*, provided that: 'For the purpose of this section, an organization which uses a formula method of apportionment in making income tax returns to this state shall determine its gross receipts from business carried on in Mississippi by applying to total unitary receipts receipts the ratio achieved, or which would be achieved, by such formula and adding to the result of such application any nonunitary Mississippi receipts' is unconstitutional because it violates the Commerce Clause (Article I, Section VIII) of the *Constitution of the United States.*" (*sic*)

The Supreme Court of Mississippi, on December 14, 1959, entered its order reversing the decree of the Chancery Court with modifications (R. 118) and filed its opinion, in which it ruled that section 9319, Mississippi Code of 1942, Recompiled, as amended, in its application to appellant for the franchise tax years 1956 and 1957, did not contravene the Commerce Clause or the

Due Process Clause of the Constitution (R. 85, 112), and that the formula prescribed by the statute resulted in a reasonable approximation of the capital used, invested or employed in Mississippi and in a measurement of the franchise tax reasonably related to the privilege granted.

It is not the appellant's contention here, nor has it been during the course of the proceedings below, that it, as a pipeline engaged principally in interstate commerce, is not subject to the franchise tax imposed on foreign corporations under section 9314 of the Mississippi Code of 1942, Recompiled, as amended. It concedes that this question was settled by the decision of this Court in *Memphis Natural Gas Co.* v. *Stone*, 335 U.S. 80 (1948). It also concedes that the amount of capital employed in the state may be determined by use of the factors of real and tangible personal property owned or used in Mississippi, gross receipts from business carried on in Mississippi, total real and tangible personal property wherever located, and gross receipts from wherever received. It does, however, dispute the validity of the method of determination of the factor of "gross receipts from business carried on in Mississippi" which is required by legislation adopted by the Mississippi State Legislature in 1956 for those organizations using a formula method of apportionment in making income tax returns. Corporations such as appellant are required under the Mississippi statute and regulations to use an apportionment formula in making income tax returns. This forces them to employ in the apportionment formula prescribed by the statute for the franchise tax a factor which does not truly represent business done in Mississippi but which incorporates extraterritorial values.

The incorporation of extraterritorial values in the factor of gross receipts from business carried on in Mississippi results in the transmutation of such extraterritorial values into a corresponding increase in the amount of capital considered employed in the state of Mississippi for purposes of the franchise tax. This, then, works a distortion of any attempt at fair allocation of capital employed within the state of Mississippi and consequently allows the Mississippi franchise tax to be levied upon a portion of appellant's capital which has no logical, rational, or discernible connection with the state of Mississippi and the purposes for which the tax is allowed to be levied.

The contentions of appellant with respect to the taxation of extraterritorial values may be illustrated by reference to the franchise tax year 1956 and specific figures, as applicable under the franchise tax apportionment formula in effect prior to the 1956 amendment and that in effect after the enactment of the legislative definition of "gross receipts from business carried on in Mississippi." In this connection, it should be noted that values used with respect to any franchise taxable year are those existing in general at the close of the previous calendar year. (Section 9315(b), Mississippi Code of 1942, Recompiled, as amended; Appendix E, *infra*). Thus, gross receipts used in the 1956 franchise tax return are actually gross receipts of the corporation for the calendar year 1955. The record shows that actual gross receipts of appellant in Mississippi for the year 1955 were $1,397,333. This figure is composed of receipts from wholesale gas deliveries in Mississippi in the amount of $1,324,944 (R. 61) plus receipts from oil properties in the amount of $66,253 (R. 43) plus rental revenue from its dwelling

houses on compressor station properties used by its employees in the sum of $6,136 (R. 43). By employment of the formula prescribed by the legislature in the 1956 amendment for the determination of gross receipts from business carried on in Mississippi, a figure of $11,204,833 is derived (R. 59, 62). Thus, the amount of receipts attributable to Mississippi business is increased $9,807,500 over actual Mississippi receipts. This increase, amounting to 801%, is obviously brought about by the employment of an arbitrary and unreasonable computation having no real relationship to appellant's business in Mississippi.

The Chancery Court, in its opinion, found that capital allocated to the State of Mississippi by employment of the formula required by the 1956 amendment amounted to $22,159,288 (R. 72), whereas, capital to be allocated to the State of Mississippi by using the factor of actual business receipts in Mississippi amounted to $19,815,750 (R. 71). Thus, capital is allocated to the State of Mississippi, and made subject to its franchise tax, in the amount of $2,343,538, that would not have been so allocated had it not been for the requirement of the 1956 amendment that the income tax apportionment formula be employed in determining gross receipts from business carried on in Mississippi. This results in the incorporation of extraterritorial income in the receipts from Mississippi business factor in the franchise tax formula, as pointed out above. It follows, necessarily, that a corresponding incorporation of extraterritorial value in the amount of capital determined to be employed in the state is brought about by exercise of the statutory formula thus distorted.

Appellant thus contends that by the incorporation of extraterritorial values in, and as a determining factor

of, capital employed in Mississippi, the state has placed upon appellant's interstate commerce an undue burden in contravention of the Commerce Clause, Article I, section 8, of the Constitution of the United States, and has deprived it of property without due process of law and of the equal protection of the laws, all in contravention of the Fourteenth Amendment to the Constitution of the United States.

THE QUESTIONS ARE SUBSTANTIAL

In a number of cases which generally have upheld the validity of state taxing statutes, this Court, in the past two or three years especially, has recognized the great importance of the area of state taxation as it impinges on, or affects in any manner, interstate commerce. These cases, of course, are so familiar to the Court as to require no citation. This case is one of novel application and is, thus, generally outside the orbit of those cases previously decided. It is, however, of similar and of equal importance both to the states and to individual taxpayers. The questions presented herein take on added significance because state taxes are one of the factors used in setting rates charged by regulated companies such as appellant. Thus, gas consumers in a large portion of the United States are directly affected by the final decision.

The constitutional questions presented in this appeal are novel in that this Court has never been called upon to decide the validity of a state franchise tax employing an apportionment formula of the precise nature here involved. Moreover, the case is of far reaching importance because the challenged statute, in employing the income tax sub-formula, referred to above and discussed further hereinafter, presents a

new and extreme method of measuring capital allocable to a state for franchise tax purposes.

This Court has held, in a number of cases where a corporation's business is of a unitary nature, being both within and without a state, that the state may impose upon the corporation a franchise tax which, in its measure, takes into consideration receipts from, and property employed in, its interstate operation. See for example, *International Harvester Co.* v. *Evatt*, 329 U.S. 416 (1947) and *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939). However, in both of these cases, each factor attributed to the state, as used in the franchise tax apportionment formula, had a definite, tangible connection with the state and was not one which, itself, was arrived at purely upon the basis of another allocation formula. It was in each instance a known quantity, pure in its derivation, and not one artificially contrived with respect to actual state affiliation. In the *Ford Motor Co.* case, capital was allocated to the state of Texas for franchise tax purposes by the employment of a formula which used the ratio of sales in Texas to total sales of the Company.

The *International Harvester* case involved the franchise tax of the state of Ohio, and allocation of capital to the state of Ohio was made by an apportionment formula which used all of the factors employed in the Mississippi state franchise tax apportionment formula here under consideration. A part of the formula was a fraction whose numerator was the total value of the business done in the state of Ohio, just as a portion of the Mississippi formula is gross receipts from business carried on in Mississippi. In the "business done" numerator of the Ohio formula, the state included as a part of Ohio business an amount equal to the sales proceeds of a part of the goods manufactured in the

taxpayer's Ohio plants that were delivered outside of the state of Ohio. Nevertheless, it should be noted that the total of business done in Ohio had a definite tangible connection with that state, that is to say, that amounts included therein represented actual sales and receipts in Ohio or represented the sale of goods which had been manufactured in Ohio. There was no attempt to compute business done in the state of Ohio by the employment of a formula which would take into consideration all of the taxpayer's receipts no matter where the goods were manufactured or sold and attempt to arrive at an approximation of what should be considered as "business done in Ohio." There was a definite nexus of the factor to the state.

In contrast to this, the Mississippi franchise tax apportionment formula, as prescribed by section 9319 of the Mississippi Code, *supra*, as amended in 1956, requires taxpayers using a formula method of apportionment in making income tax returns to abandon completely any attempt to relate gross receipts specifically to Mississippi in computing their franchise tax. They are required by the statute to depend entirely upon the arbitrary application of the income tax formula to total unitary receipts in determining the amount required to be treated as gross receipts from business carried on in Mississippi for use as a factor in the franchise tax apportionment formula.

As pointed out above, the income tax apportionment formula applicable to appellant requires the use of a ratio which is arrived at by taking the arithmetical average of the following three ratios: (a) pipeline property owned or used in Mississippi to total pipeline property; (b) Mississippi operating labor to total operating labor; and, (c) deliveries in Mississippi to total

deliveries.* The result of this is the ratio which is required to be applied to total unitary receipts for the purpose of obtaining the factor of gross receipts from business carried on in Mississippi to be used in the franchise tax apportionment formula. It can readily be seen that the requirement of the use of this additional sub-formula results in a duplication and, thereby, a multiplication of the value given to both total property owned by the taxpayer and total deliveries or receipts of the taxpayer no matter where located or received, in determining the amount of the taxpayer's capital allocable to the state of Mississippi. This duplication and multiplication of total property values and total receipts thereby results in the attribution to Mississippi of extraterritorial receipts and, consequently, the allocation of extraterritorial capital for purposes of the state franchise tax.

This employment of a formula which allows extraterritorial values having no real connection with the state to be taken into consideration in allocating capital to the state for franchise tax purposes opens a wide avenue to states to increase their revenues under franchise tax acts which might otherwise be valid. It results in the imposition of a burden on interstate commerce by allowing a portion of that commerce to be subjected to the taxing power of a state, such as Mississippi, unfairly under the guise of a franchise tax on capital and further deprives taxpayers, such as appellant, of property without due process of law and of the equal protection of the laws by taxing values extraterritorial to the state.

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*The actual provisions are contained in the Mississippi State Tax Commission Regulations No. 10, Article 250, effective with respect to the franchise tax year 1956, and in Regulations No. 11, Article 247, with respect to the franchise tax year 1957. See Appendix F, *infra*.

This is an area in which clarification should be given by this Court in the interest of guidance, not only to taxpayers, such as appellant, conducting interstate businesses, but also to taxing authorities in the administration of such laws in the several states.

CONCLUSION

The jurisdiction of the Supreme Court to review this case on appeal is clear and unquestionable. Because of the importance of the issues involved and the apparent error in the judgment of the state court, appellant urges that the Supreme Court give plenary consideration to the case and permit briefs and oral argument on the merits.

Respectfully submitted,

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